Summary Explanation: Alternative Regulation Plan For Illinois Telecommunications Carriers

This memo provides a summary explanation of the "alternative forms of regulation for non competitive services" (alternative regulation plan or alt reg plan) as contained in the telecommunications portions of the Illinois Public Utility Act. The alternative regulation plan provides a method to establish rates charged to customers for noncompetitive telecommunications services. Although any telecommunications carrier providing noncompetitive services in Illinois can petition the Commission to be regulated under this plan, only Ameritech Illinois (AI) has done so.

A review of the alt reg plan approved by the Commission for AI in 1994 is now before the Commission in ICC Docket # 98-0252 and is expected to be concluded during 2002. Documents filed in the docket may be accessed on the ICC's web page at: http://www.icc.state.il.us/icc/tc/altreg.asp

I. General Goals of the Plan

As stated in the Public Utilities Act, the general goals of the alt reg plan are:

1. Reduction of noncompetitive rates over the course of the plan.
2. Improved service quality.
3. Encourage technological innovation.

II. Key alternative regulation plan statutory provisions

There are several key statutory provisions that include the following (in relevant part):

Establishing Alt Reg - 13-506.1(a): "the Commission may implement alternative forms of regulation in order to establish just and reasonable rates for noncompetitive telecommunications services including, but not limited to, price regulation, earnings sharing, rate moratoria, or a network modernization plan."

Rescinding Alt Reg - 13-506.1(e): the telecommunications carrier must demonstrate full compliance with Section 13-506.1(b) or "the Commission may rescind its approval of Alt. Reg….if, after notice and hearing, it finds that the conditions set forth in subsection (b) of this Section can no longer be satisfied."

Conditions for approval of an Alt Reg. plan - 13-506.1(b):
"The Commission may approve the plan or modified plan and authorize its implementation only if it finds, after notice and hearing, that the plan or modified plan at a minimum:
(1) is in the public interest;
(2) will produce fair, just, and reasonable rates for telecommunications services;

(3) responds to changes in technology and the structure of the telecommunications industry that are, in fact, occurring;
(4) constitutes a more appropriate form of regulation based on the Commission's overall consideration of the policy goals set forth in Section 13-103 and this Section;
(5) specifically identifies how ratepayers will benefit from any efficiency gains, cost savings arising out of the regulatory change, and improvements in productivity due to technological change;
(6) will maintain the quality and availability of telecommunications services; and will not unduly or unreasonably prejudice or disadvantage any particular customer class, including telecommunications carriers."

Scope of Commission options for Alt Reg. plan - 13-506.1(b):
A telecommunications carrier may submit a plan for an alternative form of regulation. "The Commission shall review and may modify or reject the carrier's proposed plan. The Commission also may initiate consideration of alternative forms of regulation for a telecommunications carrier on its own motion."

III. Price Cap Index and Actual Price Index

The alt reg plan operates by applying the Price Cap Formula (also known as the Price Cap Index or PCI) to the Actual Price Index (API) for the revenues of the carrier's noncompetitive services. The reasonableness of price changes is determined by this calculation for the API should remain equal to or less than the PCI during the duration of the approved plan.

A. Price Cap Index (PCI)

The Price Cap Index is:

PCI = GDPPI - X (productivity offset or "X" factor) - Q (service quality benchmarks factor or "Q" factor), +/- Z (a possible Commission approved exogenous change factor or "Z" factor).

The PCI has two principal components: a measure of economy-wide inflation, and an off-set to the inflation measure which measures productivity (productivity offset). There also are two other adjustment variables in the Index. The components and adjustments contained in the PCI are:

Inflation Measure (GDPPI)
The economy-wide inflation measure is currently the Fixed Weight Gross Domestic Producer Price Index (GDPPI). This number is established by the U.S. Department of Commerce, Bureau of Economic Analysis prior to March 18 of each year. All parties in the current alt reg plan docket have argued for using the "Chain-Weighted" GDPPI going forward.

Productivity offset (X Factor)
The Productivity Offset is comprised of three parts: a productivity differential (set in 1994 at 1.3%) which measures the difference between telecom total factor productivity gains and overall economy total factor productivity gains, an input price differential (set in 1994 at 2.0%) which measures the difference between telecom input prices and economy-wide input prices, and a consumer dividend (set in 1994 at 1.0%) which is a "judgmental" factor imposed by the Commission based upon its expectation regarding gains that arise from technological and/or regulatory change that the Commission anticipates. The Productivity Offset was set in 1994 at 4.3% for the duration of the current Plan

Service Quality Benchmarks (Q factor)
The Service Quality Benchmarks [Q factor] that are part of the Index were established for Ameritech Illinois against actual performance in years 1990 and 1991and are part of the current alt reg plan approved for AI in 1994. Each instance of a missed benchmark leads to a Q factor (0.25%) deduction. Up to a 2.0% deduction could occur if Ameritech Illinois missed every benchmark in a year. The benchmarks are:

1. % of installations within 5 days	95.44%
2. % out of service over 24 hrs.	95.00%
3. Trouble reports per 100 access lines	2.66
4. % dial tone within 3 seconds	96.80%
5. operator speed to answer (toll)	3.60 sec.
6. operator speed to answer (information)	5.90 sec.
7. operator speed to answer (intercept)	6.20 sec.
8. Trunk groups below objecting (per yr.)	4.50

Exogenous Change Factor (Z factor)
The Exogenous Change Factor [Z] accounts for one time changes in costs which are unpredictable and out of the carrier's control. They must have an impact greater than $3 million. Ameritech Illinois attempted to recover costs associated with exogenous changes four of the first five years of the current plan, succeeding once.

B. Actual Price index (API)
The API is based on the carrier's revenues for non competitive services which services are separated into 4 service baskets. The Actual Price Index is a measure of a basket's average price. The API is calculated by dividing the proposed revenue of a basket by the current revenue of the basket and then multiplying that by the previous year's API. As noted, the API should remain equal to or less than the PCI.

The definition of what's included in the various baskets determines which of the carrier's business operations are governed by the Plan. The four baskets which make up the parts of carrier's service as set in 1994 are:

- Carrier Basket - switched access, special access, cellular access.
- Business Basket - business access and Band A through D services.

- Residential Basket - residential access and Band A, B, and C service.
- Other Basket - directory services, directory assistance, operator services, payphones, discretionary residential service, and name and address service in Chicago.

The price of an individual rate element in a basket can be increased no more than 2%, plus the change in the PCI, per year.

Since approved in 1994 for Ameritech Illinois, the reported PCI and API have been as follows:

		1995	**1996**	**1997**	**1998**	**1999**	**2000**
	PCI	**97.64**	**95.78**	**93.44**	**91.58**	**88.70**	**86.68**
Carrier	API	97.63	95.77	83.62	81.81	58.66	69.05
Resident	API	97.63	95.77	93.43	91.56	88.69	86.67
Business	API	97.63	95.76	93.42	91.57	88.69	74.82
Other	API	97.63	95.75	93.43	91.57	88.69	86.67

IV. Example of the API and PCI in action:

In 1998, the API for the residential basket was 91.56. If, hypothetically, the current revenue was $5.0 million and the proposed revenue for 1999 was $4.9 million than the equation would yield: $(4.9/5.0) * 91.56 = 88.69$.

The PCI for 1998 was 91.58. The equation that year was: $91.58 (1+ .0141\{\text{the GDPPI}\} - 0.043\{X\} - 0\{Z\} - 0.025\{Q\}) = 88.70$.

Because the API (88.69) was lower than the PCI (88.70), the statutory presumption contained in the alt reg plan is that the price changes in the residential basket were reasonable.